

OGC Has Reviewed

9 February 1956

MEMORANDUM FOR THE RECORD

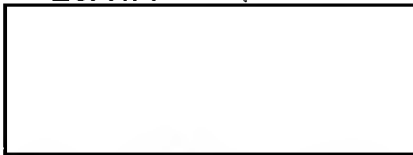
SUBJECT: Independent Contractors - Taxable Compensation

1. In conversation with Mr. Swartz (IRS) today, I discussed the taxability of payments made to independent contractors which were something other than specific compensation for services. These involve payments for increased cost of living, quarters, travel, and entertainment. (I believe that operational expenses under the manner in which this Agency functions can be eliminated from any consideration of tax liability for the individual.) I suggested to Swartz that since these people were being treated as actual independent contractors, they should not be denied proper deductions to which they would otherwise be entitled if they were not providing services for the Agency. In many cases, the cost of meals, lodging, travel and entertainment which were ordinary and reasonable business expenses would be proper items of deduction for the taxpayer on his Schedule C income. Since we would undoubtedly have security considerations however that would preclude a specific itemization to be handled in the normal manner, I proposed the possibility of our determining exactly what net taxable income an individual might have after eliminating what would appear to be otherwise proper deductions but which could not be specifically defined on a return.

2. Mr. Swartz pointed out that this is one of those problems on which revenue agents themselves are in conflict and cited the cases of oil workers, congressmen, commission salesmen, etc. It must be distinguished from the expenses of an employee who is traveling away from his principal place of business. In the case of an independent contractor, the taxpayer is entitled to deductions related to the cost of maintaining his business wherever he is but whether such expenses are ordinary and necessary over and above the usual costs of living would depend on whether he is away from his principal place of business. The definition of what is a principal place of business presents a rather tricky problem. If a contract agent is overseas for a period that is obviously temporary, we could probably support the contention that the principal place of business is actually Washington and that all expenses incurred overseas are proper business deductions. What is temporary, however, depends on the facts and there is no rule of thumb that would confine it to a three-month, one-year, two-year, or possibly even five-year period. Mr. Swartz gave an example of the private

detective who, with a business office in New York, spent considerable time on a case in Paris. As long as he did not close his New York office and begin to operate from Paris for that case and others, his principal place of business would remain in New York. Depending on the facts, it seems to me that for a number of these people their home office may ultimately be Washington and as long as we can avoid any unnatural distortion this would relieve the hardship. However, the facts will control and in view of the general confusion and difficulty in defining a principal place of business, we will have to be guided by our own common sense and good faith in each instance.

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*Per S.C.R. Lapeau*